

Chris Hemsley  
Deputy director, Railway Markets & Economics

30 November 2017

Dear stakeholders,

## Update on charges and incentives

As part of the 2018 periodic review (PR18), we are reviewing how access charges and incentives can be improved. The purpose of this work is to improve the decisions that Network Rail, train operators and funders make in order to support better outcomes for passengers, freight customers and taxpayers.

In our June 2017 charges and incentives conclusions letter, we set out a number of reforms to simplify the charges and incentives regime and to support competition on the network. The key decisions are available [here](#).

On 28 September 2017, we published a consultation on our work to develop an approach to levying charges recovering fixed network costs from all operators<sup>1</sup>, subject to a market-can-bear test. In the consultation, we set out our emerging proposals on the market segmentation for freight and passenger services. The consultation closes today (30 November 2017).

We are also assessing the financial impacts of these reforms on train operators. To support this, we have developed a model to estimate these impacts, a version of which we published in July 2017 (accessible [here](#)). This model is one element of the overall evidence base, and provides a tool to understand some of the high-level financial impacts of our decisions.

There are still a number of charging and incentive issues on which we need to conclude. These include potential changes to Schedule 4 (the possessions regime), the volume incentive and how to strengthen the alignment of incentives for collaborative working between train operators and Network Rail.

---

<sup>1</sup> *PR18 consultation on charges recovering fixed network costs*, Office of Rail and Road, September 2017. This may be accessed at <http://orr.gov.uk/rail/consultations/pr18-consultations/consultation-on-changes-to-charges-and-contractual-incentives>.

Against this background, this letter provides an overview of the working papers that we have published today and the consultation on Schedule 4 that we plan to publish in December 2017<sup>2</sup>.

### **Working paper 6: The volume incentive**

The volume incentive is designed to encourage Network Rail to make additional capacity available in response to unexpected demand from operators to use the network. However, since the volume incentive was last reviewed in PR13, several changes have occurred that may affect the effectiveness of the current volume incentive. These include the reclassification of Network Rail to a public sector arm's length government body in 2014, and the devolution of Network Rail into route businesses and a system operator.

Working paper 6 sets out our emerging views around the effectiveness of the volume incentive and its role going forward in light of these changes. We are interested in whether stakeholders consider the volume incentive has made a significant contribution to the overall incentives Network Rail faces to grow traffic on the network and whether there is a continued role for the mechanism in CP6. We note that some of the wider changes that have been taking place should help Network Rail to improve its management of network capacity, and may provide opportunities to improve its incentives to be more responsive to additional demand from operators to use the network.

### **Working paper 7: Collaborative working on the rail network**

Working paper 7 explores how incentives for collaborative working between operators and Network Rail can be strengthened. This paper reports on our engagement to date, outlines our emerging thinking and explains the next steps we will take ahead of making decisions in 2018, likely as part of the draft determination in June 2018.

In particular, the paper discusses whether there should be a move away from a one-size-fits-all mechanism such as REBS (the route-level efficiency benefit sharing mechanism) and our plans to work closely with stakeholders to explore alternatives.

### **Upcoming consultation: Schedule 4**

Schedule 4 relates to planned disruptions on the network ("the possessions regime"), which are needed to undertake maintenance, renewals and enhancements, and for emergency timetables. It has two main functions:

---

<sup>2</sup> Our working papers cover policy topics at a relatively early stage of development. The consultation on Schedule 4 will set out specific options and build on previous consultation and engagement.

1. reducing risk for train operators: the regime reduces train operators' exposure to financial risks associated with possessions (which are outside of their direct control); and
2. incentivising Network Rail: the regime provides Network Rail with financial incentives to limit the level of service disruption as a result of possessions and to notify operators early when a possession is required.

In our December 2016 consultation on changes to charges and contractual incentives, we proposed to prioritise three areas within Schedule 4 for improvement: the incentives created by notification factors; the way the access charge supplement (ACS) is calculated; and bespoke compensation arrangements.

We plan to consult in December 2017 on potential changes to notification factors and to set out our views on the case for any further changes.

### **Next steps**

We welcome all responses to the working papers, including less formal responses such as emails, bilateral or multilateral discussions on any aspects covered in the papers. We are also interested in alternative ideas and proposals in respect of the material set out within them.

A high-level timeline relating to our charges and incentives work is set out in Annex A.  
**Please send any responses on the working papers to us by 25 January 2018.**

If you wish to get in touch to discuss this letter, please email [natasha.frawley@orr.gsi.gov.uk](mailto:natasha.frawley@orr.gsi.gov.uk).

Yours faithfully,

**Chris Hemsley**

## Annex A: Timeline

| Activity                   | Date   |
|----------------------------|--|
| <b>29 June 2017</b>        | We published <a href="#">conclusions</a> on our December 2016 consultation on changes to charges and contractual incentives.   |
| <b>28 September 2017</b>   | We published a consultation on charges recovering fixed network costs.   |
| <b>30 November 2017</b>    | <p>We published:</p> <ul style="list-style-type: none"> <li>• Working paper 6 on Network Rail’s volume incentive; and</li> <li>• Working paper 7 on collaborative working on the rail network.</li> </ul> <p>We invite responses to these papers by 25 January 2018.</p> |
| <b>Early December 2017</b> | We publish a consultation on Schedule 4.   |
| <b>April 2018</b>          | Network Rail publishes draft price lists for CP6.  |
| <b>Early 2018</b>          | We conclude on some elements of the consultation and the working papers.   |
| <b>12 June 2018</b>        | We consult on our draft determination for CP6.   |
| <b>31 October 2018</b>     | We publish our final determination for CP6.  |